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Economic Conditions
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General Business Conditions

THE stupendous air assault on German Europe during the past month is accepted on all sides as the prelude to land invasion, which in turn will be the climax of the gigantic effort to which the United States has devoted its energies and resources during the past two and a half years. The work, the production and the training of those years have been for the purpose of making the invasion irresistible. Now the country is to learn whether its preparation has been effective, or whether it has not done enough and must make a still greater effort. It awaits the test soberly and anxiously, but with confidence in our armed forces and in our Allies, and with conviction that the way will be as well prepared through sea blockade and air bombing as is humanly possible.

It is true only in a limited sense that the outcome of the war is at stake in the invasion, for control of the sea and air, plus the great Russian victories, is depleting German resources and will keep the initiative in Allied hands. What is at stake is the duration of the war, and its ultimate cost. The general comment over the country shows that the idea of a long stalemate is intolerable to the armed forces and civilians alike. The victory must be decisive so that the aggressors may be stripped of power to spread disaster over the world again. It must be won as quickly as may be in order to stop the inestimable destruction of life and wealth; to cut down the cost of the war both in money and in human distress; and to allow the world to get back to peaceful work and progress.

In the weeks to come the military reports will be studied earnestly for indications whether this can be done in 1944, so far as the European theatre is concerned. Inevitably they will be weeks of strain and anxiety; and probably they will be weeks of alternating good news and bad, of varying public sentiment and of considerable fluctuations in speculative markets.

Business in a Waiting Period

The military situation naturally dominates the business situation in almost every important respect. Until the invasion is launched and appraisal of its prospects becomes possible, major policy decisions for the most part will be deferred. The importance of the length of the war to the economy at home is forcefully illustrated by the statement of Mr. C. E. Wilson, Vice Chairman of the War Production Board, that at the end of the German war 35 per cent of the productive capacity now used in war work can be released. This percentage, applied to an estimated $70 billions of industrial war production annually, would represent a cut of nearly $25 billions in war output. Particularly if it were made suddenly, such a cut would profoundly affect the position of the industries and trade and the economic situation as a whole. Business policies must take the possibility into account. But the unanswerable question is when this will happen.

It is not unlikely that cutbacks in war production may be speeded even before the collapse of Germany, whenever it is certain that the invasion is successful and it appears that the armies are making good progress. As the Truman Committee pointed out, the arms with which the invasion will be fought have already been made and the supplies accumulated. However, it seems plain that no new civilian goods programs of major importance will be put into effect until uncertainty as to the outcome of the invasion is relieved. Rather the main effort still is to increase production of needed war goods, and to keep industrial capacity open to meet unforeseen demands after the invasion starts.

With government policy following this course, the business situation shows no pronounced change. The trend of industrial production as a whole is sideways or slightly downward, with war production a little higher and civilian production a little lower. It now seems plain that the peak of the long upswing was reached last Fall, and is unlikely to be exceeded again, for two reasons. One is that

cutbacks in war contracts cause declines in some places to offset expansion elsewhere. The other is the overall limit imposed by the fact that about all the people who are able and willing to work are now employed.

Looking ahead a few months, concern as to the labor supply is somewhat lessened by the fact that the Army is now up to strength and the Navy will be fully manned by September 1, leaving only replacements to be inducted. Also, many war plants continue to save labor by increasing efficiency, and more can be done in that direction. On the other hand, women continue to leave the factories for the homes. Critics urge that the handling of selective service and of manpower problems in general could be improved to an extent that would relieve all important labor shortages; but whether this is true or not, as a practical matter the supply of labor is now the chief limitation on further expansion of production.

Merchants naturally are greatly concerned with military developments in their planning for Fall. Such a cutback in war contracts as Mr. Wilson suggests would reduce factory operations, employment and buying power in some areas. At the same time it would lead to increased production of civilian goods. Merchants thus would be doubly affected. However, the supply situation in many lines leaves them little discretion as to policy; they can buy no more than they can confidently expect to sell under almost any conditions. This is as true of cotton and rayon goods as it is of durables.

Easing in Food Supplies

One of the striking developments in recent months has been the steady improvement in supplies of a number of important foodstuffs. The most troublesome food problems this Spring have not been shortages, as was the case last Spring, but surpluses and threats of spoilage. Livestock slaughter has been at record figures and with production of eggs, milk, fresh winter vegetables and citrus fruit held at high levels by a mild open winter, cold storage facilities have been taxed to capacity. In order to make room for seasonally increased production of poultry and dairy products, particularly butter and eggs, the Government has required sharp cuts in storage holdings of frozen fruits and vegetables, poultry, variety meats and other foods. Many ration point values have been reduced and some removed entirely. Prices in a number of instances have fallen below ceiling levels, while in the case of potatoes, eggs and hogs, prices in primary markets have dropped below the Government's support level.

While the end-of-the-season food supply confounds last year's prophets of shortage, supplies for the year ahead will be determined chiefly by the results of the new crop season. It is of course too early to say much about the 1944 crops; in contrast to the threat of drought last Fall and in the early Winter, most farm areas temporarily have too much moisture, and planting of Spring crops is behind schedule. However, farmers in March were planning to plant 13 million more acres than they did last year and only one million less than the all-time record of 375 millions planted in 1932; and a late start last year was overcome very successfully.

Wheat Outlook Improves

The wet Spring has been favorable for wheat, and the Government's April estimate of 602,000,000 bushels for the Winter wheat crop, was an increase of 75,000,000 bushels over its estimate made last December when the drought was at its worst. With an average size Spring crop, the total wheat crop this year would be about as large as last year's final yield of 836,000,000 bushels. Since wheat consumption has doubled during the past two years and the carryover of about 300 million bushels on July 1 will be only about half as large as a year ago, a very large wheat crop this year would be welcomed.

There is more than a little danger that the easing in supplies of some foods just at this time, particularly in canned vegetables, may lead to false complacency with regard to the need for Victory gardens this year. Actually, the need is greater than last year. Were it not for the success of last year's Victory gardens, which according to a recent Department of Agriculture report produced a tonnage equivalent to 70 per cent of all commercially produced vegetables, there is little doubt that canned vegetables today would still command high point values instead of being point free. All communities have an interest in Victory gardens, for only a greater home production this year can keep civilian canned vegetable supplies from tightening next year.

First Quarter Earnings

A tabulation of reports issued by 295 leading industrial corporations shows combined net income for the first quarter of approximately $274 millions after taxes, which compares with $259 millions for the same companies in the first quarter of last year. This was about 6 per cent above earnings of the corresponding period of 1943, and 13 per cent above 1942, when many manufacturing companies were in the midst of conversion from peace to war goods production, but 19 per cent below the first quarter of 1941, before the entrance of this country into the war.

Earnings reported this year are still subject to reduction through renegotiation of government contracts, and therefore are not strictly comparable with last year's earnings figures,

which in numerous cases have been revised to give effect to such adjustments.

Capital and surplus of the group aggregated $12,457 millions at the beginning of this year, upon which the first quarter's earnings were at an annual rate of 8.8 per cent, compared with a net worth of $12,047 millions last year and a rate of 8.6 per cent. Our accompanying summary shows the results of major industrial groups.

About 51 per cent of the first quarter reports issued to date show an increase over last year in net income, while 49 per cent show a decrease. The principal factor in the rise of earnings was an increase in volume of sales sufficient to offset the continued advance in costs for labor, materials, supplies and taxes.

Sales figures as reported by 71 of the manufacturing companies show an increase from $3,395 millions to $4,180 millions, or 23 per cent.

Despite a further expansion in the aggregate sales of war materials, the current sales and earnings trends among leading companies in the war industries are becoming highly uneven as a result of the curtailment or cancellation of orders for many types of products, which cannot always be offset by expanded production of other products or by a shift into new lines. The steel industry is an example of how the pressure of rising costs against selling prices fixed by OPA ceilings has squeezed profit margins; despite an increase in the first quarter tonnage of steel produced, the net income of leading companies was below that of a year ago.

Income tax details reported by 157 companies in our tabulation show that reserves for federal income and excess profits taxes were at the rate of almost 70 per cent of net income before taxes, the same as a year ago, and comparing with 67 per cent in 1942 and 46 per cent in 1941. Such tax reserves are shown after deduction of the 10 per cent postwar or debt-retirement credit against excess profits taxes. This year the rate on excess profits is 95 per cent, compared with 90 per cent in 1942 and 1943, but the overall tax ceiling for federal income taxes, surtaxes and excess profits taxes combined still remains at 80 per cent. Such high tax rates of course tend to stabilize corporate net income, since taxes absorb the major portion of any increase or decrease in operating earnings.

Railroad and Utility Earnings

The railroads established new high records in the volume of freight and passenger traffic handled during the first quarter of this year. Total operating revenues of all class 1 systems reached new high levels that were approximately 8 per cent above those of a year ago, despite the suspension on May 15, 1943 of the emergency rate increases. Because of the advance in railroad wages and other operating expenses, however, the first quarter net income after charges and taxes is estimated to have fallen some 25 per cent below that of last year.

Twenty-five large public utility systems in the first quarter had an increase of about 7 per cent in total operating revenues, accompanying a further increase this year in consumption of electric power and gas in the industrial centers. Due to the continued but uneven advances in operating costs, the changes in net income after taxes were mixed, with 8 companies showing increases, 17 showing decreases, and the combined total down 4 per cent.

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST QUARTER

Net Income is Shown after Depreciation, Interest, Taxes, and Other Charges and Reserves, but before Dividends—Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Net Income First Quarter 1943	Net Income First Quarter 1944	Per Cent Change	Net Worth January 1 1943	Net Worth January 1 1944	Annual Rate of Return % 1943	Annual Rate of Return % 1944
19	Food products	$18,125	$17,737	— 2.1	$ 631.555	$ 656,561	11.5	10.8
10	Textiles and apparel	3,705	3,423	— 7.6	222,371	227,047	6.7	6.0
13	Paper products	3,060	3,205	+ 4.7	212,475	217,468	5.8	5.9
24	Chemicals, drugs, etc.	27,369	23,852	—12.9	797,417	829,184	13.7	11.5
11	Petroleum products	21,214	31,147	+46.8	1,319,306	1,410,073	6.4	8.8
12	Stone, clay and glass	5,144	7,510	+46.0	339,892	347,893	6.0	8.6
25	Iron and steel	43,511	40,311	— 7.4	3,300,473	3,347,465	5.3	4.8
9	Electrical equipment	18,994	19,352	+ 1.9	698,842	727,887	10.9	10.6
20	Machinery	6,862	8,033	+17.1	244.519	242,876	11.2	13.2
22	Autos and equipment	43,553	52,520	+20.6	1,517,748	1,618,048	11.5	13.0
48	Other metal products	31,526	30,100	— 4.5	1,254,846	1,286,410	10.0	9.4
25	Miscellaneous manufacturing	14,671	16,471	+12.3	453,967	476,800	12.9	13.8
238	Total manufacturing	237,734	253,661	+ 6.7	10,993,411	11,387,712	8.6	8.9
33	Mining and quarrying	13,397*	13,228*	— 1.3	667,327	674,889	8.0	7.8
14	Trade (whol. and retail)	4,638	3,871	—16.5	245,644	245,243	7.6	6.3
10	Service and construction	2,822	3,272	+15.9	140,963	149,144	8.0	8.8
295	Total	$258,591	$274,032	+ 6.0	$12,047,345	$12,456,988	8.6	8.8

* Before certain charges.

War Profits

Charges that business in this country is making exorbitant profits have again become prominent in recent weeks, chiefly no doubt because of statements made by labor leaders in connection with applications for wage increases and for the breaking of the Little Steel formula. In wartime especially, it is hardly possible to argue for wage increases without arguing that the industries can pay the increases without raising prices, which requires claiming that profits are unreasonably high. Such claims are part of the news of the proceedings, and are disseminated in the press and through other channels, usually without much accompanying analysis. Misconceptions, confusion, and unwitting misrepresentations follow.

For another reason also the subject is one of continuous discussion. War production and price rises have created a great rise in the money income of the country, while at the same time the war requires sacrifices by the people as a whole. Inevitably various groups and occupations dispute as to the share which each is obtaining of the increased income, and as to the extent to which each is making the necessary sacrifices. Much of this debate is uninformed, and much is animated by partisanship or prejudice. Those who are not familiar with the facts lack the means to judge critically what they read or hear, and misinterpretations which gain general acceptance are hard to catch up with.

One of the common errors with respect to business profits is to assume that exceptional instances are typical. Where profit is put above cooperation in the war effort, where salary-boosting is inordinate, or where extravagance is on an offensive scale, criticism is deserved; and the same applies to excessive demands or extravagances by any group of the population. The facts are, however, that a means of dealing with cases of exceptional profits is in operation through the Renegotiation Act, in addition to the drastic excess profits tax. Sound opinions as to business earnings can be reached only through study of overall or typical experience, rather than of the exceptions.

War Plant Payrolls, Taxes and Dividends

Corporate reports for 1943 are now available from most of the leading war producers, and from many of them facts can be ascertained not only as to earnings and profit margins, but also as to the distribution of gross income among labor, capital and the other factors in production.

We publish herewith an analysis of the figures of 50 large manufacturing companies, whose reports give payroll figures and whose 1943 sales in most cases exceeded $50 millions each and were principally of war materials. These companies are not "selected" in any sense except that they are large war producers; all available reports which give the desired detail are included. Certain composite figures for the group are shown on the accompanying chart, while total income and expense figures are given in the table in greater detail.

50 Leading Manufacturers of War Materials

(In Millions of Dollars)

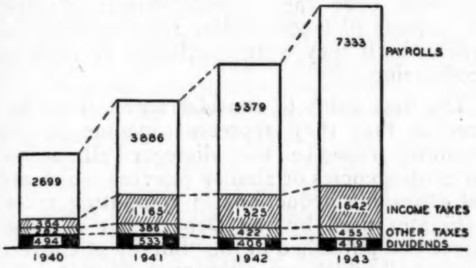
Income Account	Year 1940	Year 1941	Year 1942	Year 1943	% Change 1940-43
Net sales and other revenues	$8,292	$12,182	$15,212	$20,567	+148
Cost of goods and services purchased from others, depreciation, interest and other expenses and reserves	4,201	5,919	7,459	10,497	+150
Balance of gross income	4,091	6,263	7,753	10,070	+146
Distributed as follows:					
Wages and salaries	2,699	3,886	5,379	7,333	+172
State, local, social security, foreign and misc. fed. taxes	282	386	422	455	+ 61
Income and excess profits taxes	364	1,165	1,325	1,642	+351
Total taxes	646	1,551	1,747	2,097	+225
Dividends paid	494	533	406	419	− 15
Income retained	252	293	221	221	− 12
Total net income	746	826	627	640	− 14
Percentage distribution of above "Balance of gross income"					
Wages and salaries	66.0	62.0	69.4	72.8	
Taxes	15.8	24.8	22.5	20.8	
Net income	18.2	13.2	8.1	6.4	
Total	100.0	100.0	100.0	100.0	

These companies, a large number of whose plants have been awarded the Army-Navy "E" for excellence in production, include the following:

Alleghany Ludlum Steel Corp.
Allied Chemical & Dye Corp.
Allis-Chalmers Mfg. Co.
American Brake Shoe Co.
Am. Radiator & Std. San. Corp.
American Rolling Mill Co.
American Viscose Corp.
American Woolen Co.
Armstrong Cork Co.
Baldwin Locomotive Works
Bethlehem Steel Corp.
Blaw-Knox Co.
Botany Worsted Mills
Bridgeport Brass Co.
Burlington Mills Corp.
Caterpillar Tractor Co.
Container Corp. of Amer.
Crucible Steel Co. of Amer.
Dresser Manufacturing Co.
Douglas Aircraft Co.
Eastman Kodak Co.
Fruehauf Trailer Co.
General Electric Co.
General Motors Corp.
Goodyear Tire & Rubber Co.
Inland Steel Co.
International Harvester Co.
Johns-Manville Corp.
Jones & Laughlin Steel Corp.
Lukens Steel Co.
Glenn L. Martin Co.
National Gypsum Co.
National Steel Corp.
National Supply Co.
Packard Motor Car Co.
Pepperell Manufacturing Co.
Pittsburgh Steel Co.
Pullman, Inc.
Radio Corporation of Amer.
Republic Steel Corp.
Sun Oil Co.
Thompson Products, Inc.
United States Rubber Co.
United States Steel Corp.
Western Electric Company
Westinghouse Air Brake Co.
Westinghouse Electric & Mfg. Co.
Wheeling Steel Corp.
Willys-Overland Motors, Inc.
Youngstown Sheet & Tube Co.

As indicated by the list of companies, the group includes representative producers in the steel, machinery, electrical equipment, auto-

motive, aircraft, chemical, rubber, textile and other lines which are the backbone of the country's new war industries, and which have been largely responsible for the tremendous expansion of output achieved during 1942-43. These 50 companies account for a sizeable part of total war production.



Payrolls, Taxes and Dividends Paid by 50 Large Manufacturers of War Materials
(In Millions of Dollars)

It will be seen from the table that aggregate sales of the 50 companies expanded from $8,292 millions in 1940 to $20,567 millions in 1943, or 148 per cent. After deduction of the cost of goods and services purchased, depreciation, interest and other expenses and reserves, the balance of gross income increased from $4,091 millions to $10,070 millions and was distributed as follows:

(1) Wages and salaries increased from $2,699 millions to $7,333 millions, or 172 per cent.

(2) Total taxes — federal, state and local — increased from $646 millions to $2,097 millions, or 225 per cent.

(3) Total dividends—preferred and common—decreased from $494 millions to $419 millions, or 15 per cent.

(4) Retained net income decreased from $252 millions to $221 millions, or 12 per cent.

In some cases 1943 published figures may overstate real earnings, in that net income as reported is subject to renegotiation of government contracts.

The total average number of employes of these companies, partly estimated, increased from approximately 1,514,000 in 1940 to 2,711,000 in 1943, or 79 per cent. Average annual compensation increased, as a result of higher basic wage rates and overtime, from approximately $1,800 to $2,700, or 50 per cent. The combination of these increases in numbers and in compensation resulted in the increase in total payrolls of 172 per cent.

In contrast with this expansion in payments to labor, the dividend payments to approximately 2,002,000 registered shareholders were, as stated, 15 per cent lower in 1943 than in 1940. Total net income, after taxes but before dividends, was 14 per cent below 1940.

After deduction from gross income of all expenses and charges except labor and taxes, the distribution of the remaining balance was as follows: wages and salaries 72.8 per cent in 1943 compared with 66.0 per cent in 1940; taxes 20.8 per cent compared with 15.8; and net income (which is the "wage" accruing to the shareholders for supplying plants, tools, and working capital for carrying on production), 6.4 per cent compared with 18.2. Payrolls in 1940 were 3½ times net income; in 1943 they were 11 times net income.

Carrying the earnings comparison to years prior to 1940—not shown in the table—net income of these companies in 1943 was less than in 1937, substantially greater than in the depression year 1938, and larger than in 1939. It was 24 per cent larger than the 1936-39 average (years of partial depression).

Profit Margins

Another significant point brought out by the figures is the decline in profit margins. Despite the increase in volume of business during the war, the average margin of net profit after taxes per dollar of sales, for the 50 companies, has narrowed as follows:

1939	8.0c
1940	9.0c
1941	6.8c
1942	4.1c
1943	3.1c

These figures demonstrate the fact, not always understood, that war production has been carried on at substantially smaller profit margins than the normal peacetime business of these companies. As compared with World War I, the Treasury statistics on income show that all manufacturing corporations carried 10 per cent of their gross through to net after taxes in 1917, and 5.5 per cent in 1918.

The Question of Reserves

Published financial statements of corporations — from which the foregoing figures are taken—are sometimes criticized on the ground that net income is shown *after* deduction of reserves for contingencies, reconversion of plants or other postwar purposes, and that this causes an understatement of real earnings during the war. It has been charged that corporations are preparing a "postwar orgy" for shareholders. The need for reserves of this sort, however, is undeniable, and the treatment of reserves as proper charges against income is standard accounting practice. The various common types of wartime reserves have been the subject of extensive study during the past year by such organizations as the

Treasury Department, Securities and Exchange Commission, and American Institute of Accountants.*

All of these studies accept postwar reserves in principle: the only question is one of size. While it is hardly to be expected that forecasts exact to the last dollar can be made of the numerous extraordinary expenses and losses that large war products manufacturers will face at the end of the war, resulting from conversion to war work and therefore proper charges against war earnings, anyone who claims that reserves are excessive is setting his own opinion against the experience and judgment of the companies' own executives and accountants. The prices at which shares of such companies are selling indicate that if an "orgy" is being prepared for them, stockholders are unaware of it. There is no saving of taxes through setting aside contingency reserves of excessive size, inasmuch as such reserves are not legal deductions for tax purposes, but become so only when the anticipated expenses or losses are actually incurred.

In the balance sheets of the 50 large war material manufacturers in our study, the combined total of all reserves—including reserves allocated to specific purposes, general or unallocated reserves, and reserves not definitely described, and including routine operating reserves as well as special wartime reserves—increased from $435 millions at the end of 1940 to $892 millions at the end of 1943.

The latter figure is a large dollar amount. However, it represents but 6 per cent of the total assets of these companies, which during the same period had expanded from $9,868 millions to $13,960 millions in meeting the unprecedented demands for production of war materials. In view of the problems and uncertainties which these companies face in the postwar period, the real danger is that the reserves may prove to be less than adequate, rather than excessive.

Total Corporate Earnings

With respect to the large war producers, the foregoing figures are conclusive, and if they had as much currency as the unsupported charges that war producers are "having a field day," etc., the charges would soon be disposed of. Many current misrepresentations, however, relate to the earnings of corporations as a whole rather than to war producers specifically.

*See "Postwar Expenses Related to Wartime Incomes", Division of Tax Research, Treasury Department, October 1943; also "Report on Corporate War and Postwar Reserves, 1939-1942", Securities and Exchange Commission, October 1943; also "Special Reserves Arising Out of the War", Research Department, American Institute of Accountants, reprinted in "Journal of Accountancy", November 1943.

In the last issue of this Letter appeared a table giving the net income after taxes of all active corporations in the United States as reported by the Treasury, including Treasury estimates for 1942 and 1943. The 1943 estimate is $8,550 millions, which is an increase of 84 per cent over the 1940 figure, and of 157 per cent over the 1936-39 annual average. Statements of labor leaders refer to these increases as if they were conclusive evidence of profiteering.

The first point to consider about these figures is that they represent income in the statutory sense; i.e., they disregard all charges for contingencies or similar reserves which are not allowable deductions in computing taxes. Estimates used by the Department of Commerce and published in the "Survey of Current Business," which are often quoted, are on the Treasury basis rather than the customary accounting basis.

The second point is that percentage increases signify little when applied to earnings without consideration of conditions in the base period, changes in volume, capital employed and similar factors. The active corporations in the United States, numbering about 469,000, include a vast number which in the pre-war period were operating either at a loss or close to it. An "increase" in profits of companies which had been operating at a loss is not computable in percentage terms, and reasonable gains made by those which had been barely breaking even become astronomical when expressed as percentages.

It is natural and beneficial in all respects that "poor" companies or industries should show large earnings increases when the country requires a greatly increased output of their products or services. The point to be made here is that their showing inflates the figure of average percentage gain and makes that figure unrepresentative of the efficient, going concerns which were earning reasonable profits before the war. Few such concerns have had increases corresponding to the averages above given; few could have had, in view of the excess profits taxes and the renegotiation statute.

Distribution of Income

Comparisons of percentage increases in wage rates with percentage increases in business earnings — which of course show the former at a disadvantage — are frequently made, in support of assertions that labor is receiving an inequitable share of the increase in national income. But this comparison is logically unsound, for the things compared are unlike. One is a rate, the other an aggregate. One has a firm and relatively stable base, the base of the other is unstable. Corporation earnings are good in busy times, but shrink rapidly or turn

into losses in poor times, while wage rates hold or decline relatively little even during depression. The rigidity of wage rates, which represent the cost of labor, may in fact be a major cause of the drying up of corporate income.

There is little excuse for misrepresentation as to the distribution of national income, for the facts are easy of access. The U. S. Department of Commerce compiles the figures and analyzes them in many ways. The following table shows the distribution of income for 1943, 1940 and the prewar years, giving separately the compensation of employes and of the other factors in production. It will be seen that employes received 71.1 per cent of the total as against 68 per cent in the prewar years, and that agriculture likewise increased its percentage, while the share of business (combining corporate and non-corporate) decreased.

Distribution of National Income

	Percent of Total		
	1936-39	1940	1943
Total National Income	100.0	100.0	100.0
Total compensation of employes*	68.0	67.4	71.1
Net income of incorporated business	5.0	7.5	6.0
Dividends	6.0	5.2	2.7
Corporate savings	—1.0	2.3	3.3
Net income of agriculture	6.5	5.7	8.3
Net income of other proprietors	9.7	9.8	7.9
Interest, rents, and royalties	10.8	9.6	6.7

*Includes salaries, wages, employers' social security and pension fund contributions.

The "23,000 Millionaires"

A familiar statement, given circulation recently by C.I.O. President Philip Murray in a Senate hearing, is that in World War I the war profits "created 23,000 millionaires." Along with this Mr. Murray pointed out that total dollar profits in this war are larger than in the last, and said, "It is difficult to prognosticate the number of millionaires this war is going to create." The implication is that "it happened before and it is happening again."

Space does not permit discussion of the claim that the last war created 23,000 millionaires, except to say that it is based upon questionable assumptions and interpretations of income statistics. The question of present importance is not whether the history is correct but whether the implication that "it is happening again" has any foundation. People who are impressed should recall that at the present level of individual income taxes (disregarding the unforgiven part of 1942 taxes) even a man with an income of a million dollars a year, if he spends nothing at all on personal living and pays out nothing except his federal income taxes, would require about ten years to accumulate a million dollars. How little substance there is in Mr. Murray's suggestion may be judged from this fact.

On January 6th a minority of the Senate Committee on Finance submitted a report on the revenue bill of 1943 in the course of which the "23,000 war millionaires" of World War I were referred to. But this same report said: "The renegotiation statute has provided an effective means of limiting war profiteering. Under it war contractors have been allowed liberal profits on their war business but *inordinate profits have been eliminated.*" (Italics ours.)

Vice President Wallace in an address before the Political Action Committee of the C.I.O. in New York on January 15 made the following statement:

> . . . Some claim that the corporations have been growing rich out of the war. This may be true in some cases but, even though Congress has not carried out in full the recommendations of the President and the Secretary of the Treasury, the facts are that in this war we have done a much better job in covering back into the Treasury excess profits than we did in World War I. The corporations during the past two years made gross profits two and a half times as great as in the two years of World War I but they paid taxes nearly five times as great. Taxes in World War II have been used twice as effectively to recover excess profits as in World War I.

It may be added that in comparing gross profits with those of World War I the reader should allow for the overall growth in economic activity and the tremendous increase in the plant, tools and capital employed compared with 25 years ago.

Postwar Needs

It should be said in conclusion that comparisons of earnings with the *past,* and arguments erected upon them, not only prove little but confuse the issue. Whether profits are too high or too low is to be determined, not by reference to past relationships or arbitrary standards, but by their effect upon the growth of business and employment. The fundamental question is whether a strong and healthy economy, able to meet the needs of the *future,* is being maintained.

At the outbreak of the war business had gone through a long depression, during which the net worth of all active corporations declined by $25 billions. (Reference is made to the table in the April issue of this Letter, page 47). At the end of 1943 some $10 billions of this loss had been recovered. But business capital is still much below pre-depression levels.

The wartime earnings of the corporations are being devoted chiefly to replenishment of capital rather than distributed to shareholders, as shown by the table on the distribution of national income and the other evidence as to dividends previously given. Earnings are being plowed back for the purpose of accumulating the financial resources necessary for the

future, and for retiring debt and strengthening capital structures. Reserves for postwar expenses, losses and contingencies are being set up.

If the country is to prosper after the war it will want a higher level of production and employment than ever before, and business needs to build up its capital resources accordingly. It can do so only if profits are high enough to induce enterprise and investment and to supply savings needed for investment. Incomparably the most important principle to be observed in the discussion is that prosperity depends upon strength and health in business enterprise.

Plans for World Currency Stabilization

Planning for postwar collaboration in stabilization of currencies has moved forward to a second stage with publication by the financial technicians of the United and Associated Nations of a joint statement of principles governing the establishment and operation of an international stabilization fund. The first stage in the process of working out a common program in this area may be considered the publication a year ago of the original White and Keynes plans, followed in June by publication of a Canadian experts' plan. While the formulation of these original proposals had involved consultation between the experts of the various governments, nevertheless the published plans represented separate approaches to the problem of postwar monetary stabilization. Obviously, the next logical step was to try to iron out the differences at the technical level and obtain agreement among the experts upon a single set of proposals.

As stated in the text of the joint agreement, governments are not asked to give final approval to the principles set forth until they have been embodied in the form of definite proposals by the delegates of the United and Associated Nations meeting in a formal conference. The plan outlined is still tentative, without official endorsement, and subject to such further clarification and amendment as continuing analysis and discussion may determine.

That progress has been made is evident from study of the new proposals. While there remain important points that need further consideration, the new set-up is on the whole simpler and more understandable, and certain features of earlier drafts that encountered objection have been modified or dispensed with. The statement goes further than the earlier proposals in distinguishing between the needs of the transition period at the close of the war and the needs of the later period when more orderly conditions will have been reestablished.

An $8 Billion Stabilization Fund

As an agency for effecting international monetary cooperation, the proposals contemplate a permanent international institution, or fund, with assets of $8 billions in gold and foreign exchange if all United and Associated Nations subscribe, and $10 billions if all countries come in.

Member countries would be asked to subscribe their shares, or quotas, according to an agreed formula which, though not spelled out in the published text, is understood to take account of the proportion of each country's trade to world trade, its gold holdings and gold production. On this basis the United States, it was stated, would contribute between $2½ and $2¾ billions; Great Britain about $1¼ billion; Russia about $1 billion; China from $550 millions to $600 millions; and Canada perhaps $300 millions.

Each member country would be expected to pay in 25 per cent of its subscription in gold, or 10 per cent of its holdings of gold and gold currencies, whichever is less; with the balance in local currency. For the United States with its massive gold holdings this would mean a gold contribution of 25 per cent of its subscription, or a little over $600 millions, with the balance in the form of a credit on the books of the Federal Reserve Banks. Great Britain, on the other hand, would doubtless contribute on the basis of 10 per cent of total gold and gold exchange, as likely to yield the smaller of the two sums allowed.

Management of the fund would be vested in a governing board representative of each member country, but with active conduct of affairs delegated to an executive committee consisting of at least nine members including representatives of the five countries with the largest quotas—presumably the United States, Great Britain, Russia, China, and France. Voting power would be "closely related to quotas," with the United States having the largest individual vote and not less than that of the British Empire.

"Bancor" and "Unitas" Out

The new plan would do away with the proposed monetary units "bancor" and "unitas" of the original Keynes and White plans, and all

currencies would be related directly to gold. Par values of currencies would be fixed by agreement between the country and the fund at the time of a member's entrance to the fund, and once fixed could not be changed without the fund's consent except to the extent of an initial 10 per cent so long as a country remained a member. Member countries would not be expected to propose, nor the fund approve, currency changes save for correction of a fundamental disequilibrium in the balance of payments.

In other words, each member country makes a commitment not to make currency changes lightly, or use them as an instrument of trade warfare. Member countries would agree not to impose restrictions on payments for current international transactions (as opposed to capital transfers) or engage in discriminatory currency arrangements without approval of the fund.

Conditions of Borrowing

In return for its subscription and for otherwise agreeing to abide by the rules of the fund, a member country running behind in its balance of payments would have the right to purchase (borrow) other currencies from the fund. Such rights would, however, be subject to certain limitations—

(1) A country could not borrow from the fund to finance a large and sustained outflow of capital (use of exchange controls being permitted under such circumstances).

(2) A country could not (except upon express permission of the fund) borrow more than 25 per cent of its quota in any 12 months period, nor to an amount where the fund's holdings of the currency of the country exceed 200 per cent of its quota.

(3) The fund may at any time, after adequate notice, suspend a member from further borrowing if it deems that member to be making improper use of the resources of the fund.

Where the reverse is the case, and a member's currency is becoming scarce, as seems likely to be the case with the dollars after the war, the fund would be expected to apportion the scarce currency, and to "issue a report embodying the causes of the scarcity and containing recommendations designed to bring it to an end." The fund could also at its option borrow such scarce currency from the member country, presumably from the central bank; and, as an additional measure, other member countries could, on consultation with the fund, temporarily restrict dealings in the scarce currency.

In all transactions the fund would deal only with national Treasuries, central banks, stabilization funds, and other fiscal agencies, and would not compete with private institutions in the market. It would keep its account in each country at the central bank. Member countries would be able to withdraw from the fund by giving notice in writing, in which case the reciprocal obligations of the fund and the country would be liquidated "within a reasonable period."

Finally, the statement of the experts makes plain the important qualification on the use of the fund that the plan is not intended to cover the needs of the transitional period immediately after the close of hostilities. While the plan makes special provision for the continuance of exchange controls during this period, it says specifically that the fund "is not intended to provide facilities for relief or reconstruction or to deal with international indebtedness (blocked balances) arising out of the war." The fund looks chiefly towards the maintenance of exchange stability in the more nearly normal period beyond, and would have to be implemented by other measures for dealing with the more immediate problems.

Looked at in perspective, what the plan seems to contemplate is a return to a form of modified gold standard, with all countries tying their currencies to gold, and with gold continuing to serve in settlement of international transactions. Member countries not borrowing from the fund could buy and sell gold at the agreed price subject only to the restriction that a country desirous of purchasing foreign currency with gold would be expected to buy it from the fund "provided it can do so with equal advantage." Sale of newly-mined gold would be permissible on any market, thus assuring a broad outlet for the gold producing countries.

The fund would provide a mechanism for the collection of information and for continuing study and consultation upon international monetary problems. This perhaps might be its most useful function. Such an institution could aid in the difficult problems of determining exchange rates, in acting as intermediary in the arrangement of credits between countries, and in other ways where authoritative information, expert counsel, and harmony and close

cooperation between nations are essential. The experience with the Bank for International Settlements demonstrated the value of a permanent institution in this field. Opinion today is widely agreed that some kind of an international monetary institution is desirable, but there is distrust of proposals that seem grandiose and over-ambitious.

The Question of Credits

Where the chief question arises and the closest scrutiny is called for is generally recognized to be in the matter of credits. Any lending institution, be it a world bank or a "Main Street" bank, must stand or fall by the soundness of its terms of credit. Countries likely to be on the creditor side of the proposed international fund naturally want to know what safeguards there will be to protect the money they put in.

Unfortunately, it is precisely upon this point that the plan, as published, is most obscure. Apart from the provisions relative to the percentage of its quota that a member country is presumed to be entitled to borrow, there appears to be little in the way of limitation upon the debtor country other than the general discretion of the fund. While there are admittedly difficulties in laying down precise rules and regulations in the granting of credit, some further spelling out of the criteria for access to credit seems essential if the scheme is to command confidence.

Long experience in the lending of money shows that proper limitations have to be placed around it, and that there needs to be a constant incentive for the borrower to restrain his borrowing and repay as promptly as possible, for the temptation the other way is always great. It would accord with this principle if advances made through the fund — even those limited amounts which are made semi-automatically — should bear a suitable rate of interest.

The foregoing is all the more necessary in view of the large sums at the disposal of the fund, the grave difficulties to be anticipated in the transition period, and tendency always for countries experiencing currency troubles to rely upon credit rather than take the hard and often painful steps needed to put their own houses in order. It must be borne in mind, after all, that the managers of the fund will be engaged in lending other people's money, and that contrary to the practice of most lending institutions the "board of directors" will be made up for the most part of the debtors.

In the light of these considerations, two further crucial questions arise—

1. Whether there is as yet adequate distinction being made between the needs of the transition period when the most pressing call will be for relief and long-term loans for reconstruction and for the unfreezing of the huge volume of blocked international funds—mainly sterling—, and the needs of the later period when more normal equilibrium will have been restored. While the plan states that the fund is not intended to be employed for the former purposes, it is not clear that once the fund is set up and borrowers are admitted to its facilities it will be possible to so identify exchange transactions as to prevent the fund from becoming encumbered with non-liquid assets.

2. Whether the whole set-up and theory of an \$8 to \$10 billion fund, with borrowing quotas for thirty or more countries, is not on altogether too elaborate a scale. A fund of \$8 billions is a lot of money, especially when it is conceded that this would be only one of the requirements for credit and capital in the post-war international sphere, and not the most urgent at that. First comes the question of direct relief for war-stricken areas, for which the United Nations Relief and Rehabilitation Administration has been set up with a capital of \$2½ billions, of which the United States share is \$1,350 millions. Next comes the question of long-term credit to deal with the key problem of blocked sterling balances and for long-term rehabilitation and development in other areas. Just how many billions will be needed for these purposes is hard to say, but it will be remembered that there is afoot a plan for a United Nations Bank for Reconstruction and Development, with \$10 billions of capital of which the United States would be expected to put up a substantial share, to guarantee long-term private investments in areas where private capital would be unwilling to take the risks alone.

Whatever the amounts or the methods, it is realized that a currency stabilization plan could not operate successfully unless and until something like normal international relationships and sound internal economies have been reestablished. Which prompts the average person to inquire why, once the transition problems have been dealt with, it will require so much money to meet the exchange exigencies of more ordinary times. There is apprehension that, with a fund of such proportions operating on the quota system, debtor

countries may be encouraged to think that they have a *right* to credit up to the amount of their quotas, thus discouraging the taking of adequate corrective measures at home and resulting in pressures upon the fund that would either be hard to resist or, if resisted, would be productive of much misunderstanding and ill will.

The Principles that Must Govern

In concluding these remarks, and particularly by way of suggesting the relative importance and successive development of orderly steps towards monetary stability, we quote a few paragraphs from a report issued in September last by the Economic Policy Commission of the American Bankers Association, entitled "The Place of the United States in the Post-War Economy." In commenting upon the original White and Keynes plans, that report said in part:

"It seems wise to emphasize again the fact that no institution no matter how well designed can work miracles — an illusion too often cherished. Basically stable money is possible only with stable national economies. Towards this goal the United States must lead the way. The first requisite for any genuine progress towards stabilization is a stable dollar free of all exchange restrictions, a dollar in which the world has full confidence. Regardless of the standards adopted, or the organization set up, some strong currency must in fact be the main steadying influence. So far as can now be foreseen the foundation currency must be the dollar.

"The second step should be to establish definite rates between the dollar and the pound sterling — the two currencies in which the major part of world trade has been conducted for the past century. This step involves the whole problem of the reestablishment of the British monetary and trade position on a sound basis. We must assist in the solution of this problem if currency stability is to be achieved promptly. It is probably wiser to grapple frankly and directly with this question rather than merging and partly concealing it in a general international plan.

"Once the values of the dollar and the pound are determined others will follow, for certain currencies are now stable in relation to the dollar or the pound, and other countries could gradually make the necessary adjustments. Where financial aid is needed it should be granted only after due consideration of the merits in each individual case. Each country must of necessity work out its monetary salvation largely by its own efforts. It cannot shift responsibility. In this process the presence of an institution as a mechanism to encourage consultation would be useful, but its function as a lender of money can only properly begin when a sound economic program has been put into effect.

"Furthermore, it should again be emphasized that the United States cannot successfully promote international monetary stability without making determined efforts to put its own affairs in order by balancing its budget and checking inflationary influences. If our fiscal policies in time of peace continue to rest on the principle of deficit financing, all efforts to maintain international monetary stability will inevitably fail. Confidence in the dollar would be further enhanced by a clear cut policy making the dollar redeemable in gold, in foreign trade, with no deviation from the present value."

It is our belief that these observations, made over six months ago, are equally applicable today. In all these plans for making a better world we have to take account of the way people think and behave. We have to bear in mind that to carry people along with us on any program the program must be simple and logical and in terms that people can understand. This means, in the case of the proposed currency plan, avoiding things that are too ambitious and sticking as nearly as possible to the time-tested principles of lending with which people are familiar.

With the universal recognition that some form of cooperative action is necessary, it should be possible, with the good will that exists, to carry on the work that has been begun and map out a program that will have the public confidence and support which is indispensable if it is to work.

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